# TOC Chained CPI CP

## 1NC Shell

#### CP Text: The living wage policy that the aff advocates should be indexed to the chained CPI rather than the Consumer Price Index.

#### Counterplan is better for businesses, which increases employment, better maintains real purchasing power of minimum wage, and allows for economic recovery.

#### ZANDI 14 [Mark Zandi, Chief economist of Moody’s Analytics[[1]](#footnote-1) where he directs economics research, A trusted adviser to policymakers and an influential source of economic analysis for businesses, journalists and the public, Dr. Zandi frequently testifies before Congress on topics including the economic outlook, the nation’s daunting fiscal challenges, the merits of fiscal stimulus, financial regulatory reform, and foreclosure mitigation- Dr. Zandi conducts regular briefings on the economy for corporate boards, trade associations and policymakers at all levels. He is on the board of directors of MGIC, the nation’s largest private mortgage insurance company, and The Reinvestment Fund, a large CDFI that makes investments in disadvantaged neighborhoods. He is often quoted in national and global publications and interviewed by major news media outlets, and is a frequent guest on CNBC, NPR, Meet the Press, CNN, and various other national networks and news programs. “In Support of Raising the Minimum Wage”, https://www.economy.com/getlocal?q=DFF228B2-8D70-4B2B-B55D-11D4247B6E28&app=eccafile, February 2014, DDA]

The Fair Minimum Wage Act is a reasonable starting point for debate over increasing the minimum wage. It would result in wage increases for some 16.5 million workers and lift almost 1 million workers above the poverty line by 2016.5 Yet FMWA is overly aggressive given the halting economic recovery. The law would increase the minimum wage almost 40% three years after enactment, equaling an increase of 13% per year. Although this is roughly equivalent to the increase in the minimum wage between 006 and 2009, the minimum wage was much lower on a real basis at that time. Thus, despite the sizable increase, market wages were still clearly higher in most parts of the country. Given the damage done to the job market in the Great Recession and the stagnant real wage growth since then, the FMWA’s proposed increase will be meaningfully harder for businesses and the job market to digest gracefully. The law would decrease employment by an estimated 420,000 jobs by year-end 2016. To help with the adjustment, the minimum wage should be increased to $10.10 per hour as proposed by FMWA, but over five years beginning in 2015. This would translate into an 8% per year increase in the minimum wage— still a significant increase but manageable, especially if the job market improves as expected. At the current pace of improvement, unemployment and labor force participation will return to near levels consistent with full employment by 2017. Real market wages should be rising consistently by then. Pushing the first increase in the minimum wage to 2015 would also provide businesses more time to prepare and adjust. At $10.10 per hour, the minimum wage at the start of 2020 would also make it comparable to the minimum wage in the average OECD country. Under reasonable assumptions about future U.S. and global wage growth, the U.S. minimum wage would be approximately equal to 45% of the average U.S. wage for production and nonmanagerial workers. This would be squarely in the middle of the distribution of OECD countries. After 2020, the minimum wage should be indexed to inflation. This would provide some certainty both to employers and workers. It would also reduce wage volatility, preventing real wages from falling over long periods until lawmakers act to raise them sharply. Indexation would make the adjustment process predictable and thus less costly. Lawmakers should also consider using the chained consumer price index to adjust the minimum wage. While controversial, given recent failed legislative efforts to adopt the chain index to calculate increases in Social Security benefits, it is a more accurate inflation measure than the conventional CPI. The chained index increases at a pace more consistent with the prices businesses are able to charge. Using it to index the minimum wage will thus ensure that the minimum wage maintains real purchasing power but does not cut into businesses’ profit margins and their ability to hire. Fixing the subminimum wage for workers to 50% of the minimum wage would also bring it back near its original level in real terms. This is less than the 70% wage proposed in the FMWA, but well above the current 35%. Fixing the subminimum wage for work- ers to 50% of the minimum wage would also bring it back near its original level in real terms. This is less than the 70% wage proposed in the FMWA, but well above the current 35%. Making these adjustments to the FMWA would mean fewer low-wage workers would be lifted out of poverty, but it would significantly mitigate any employment effects. By the end of 2016, employment would be re- duced by an estimated close to 80,000 jobs. By 2020, the impact on employment would not be statistically significant from zero.

#### B. Competition:

1. Functional-

1. CP uses a different measure to index inflation.

2. Net benefits- CP doesn’t link to the disads.

*avoids politics DAs*

#### C. Solvency:

**CPI leads to greater employer spending because it overestimates cost of living, which harms the strength of local businesses.**

**CBO 10** [Congressional Budget Office, Since its founding in 1974, the Congressional Budget Office (CBO) has produced independent analyses of budgetary and economic issues to support the Congressional budget process. The agency is strictly nonpartisan and conducts objective, impartial analysis, which is evident in each of the dozens of reports and hundreds of cost estimates that its economists and policy analysts produce each year, “Using a Different Measure of Inflation for Indexing Federal Programs and the Tax Code”, http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/112xx/doc11256/cpi\_brief.pdf, February 24, 2010, DDA]

Although the CPI is not a true cost-of-living index, BLS’s goal in computing it is to estimate[s] the growth in the cost of living by measuring the change in the cost of a “market basket” of goods and services that represents average consumer spending.2 The market basket is based on data from BLS’s Consumer Expenditure Survey, in which thousands of families report what they actually bought. BLS divides those purchases into 211 categories—such as breakfast cereal, rent on a primary residence, women’s dresses, and wireless telephone services—and assigns a percentage weight to each category based on its share of consumer spending in a base period. To measure price changes, BLS chooses about 80,000 specific items (several hundred for each category) and checks their prices every month at selected stores and other establishments in 87 urban areas. BLS uses those price data to compute various versions of the CPI, two of which are currently used to index federal programs. The consumer price index for all urban con- sumers (CPI-U) is based on the average spending of almost all residents of urban or metropolitan areas— about 87 percent of U.S. residents. The consumer price index for urban wage earners and clerical workers (CPI- W) focuses on a subset of the CPI-U population: house- holds that include clerical workers, sales workers, labor- ers, or certain other types of nonprofessional employees. The CPI-W population represents about 32 percent of U.S. residents. The two versions of the CPI produce similar estimates of inflation. Over the past 20 years, CPI-W inflation has averaged 2.65 percent a year, and CPI-U inflation has averaged 2.69 percent. The Congressional Budget Office (CBO) expects that the two measures will grow at about the same rate in the future. Every two years, BLS uses new survey data to update the share of consumer spending devoted to each of the 211 categories in the market basket. As a result, at any given time, the CPI is based on spending patterns from two to four years earlier. For example, the monthly values of the CPI computed in 2008 and 2009 were based on spending data reported in the Consumer Expenditure Survey in 2005 and 2006. For the monthly values begin- ning in January 2010, BLS used new data to update the market basket to reflect purchases made in 2007 and 2008. Because the CPI is based on spending patterns from a point in the past, it does not fully incorporate the effects of economic substitution. Therefore, the CPI grows faster than the cost of living does. That substitution bias would exist whether the market basket was from one month ago or five years ago. However, greater periods of time between updates to the basket tend to magnify substitution bias and to cause an even larger gap between the increase in the CPI and growth in the cost of living. BLS’s procedures account for the effects of substitution within most basic categories of goods and services in the market basket—such as when some consumers who previously bought large grade-A eggs switch to medium- sized eggs when the latter go on sale.3 However, the index does not take into account shifts that occur between one category and another. For instance, if the price of apples rises by 50 percent and the price of bananas goes up by only 10 percent, consumers will tend to buy fewer apples and more bananas. Because apples and bananas are separate categories in the CPI market basket, the index does not account for the effects of such substitution. As a result, it overstates the amount by which consumers’ well-being declines when prices rise and understates the benefit of price reductions.

**Chained CPI solves for goods substitution bias.**

**CBO 2**

In reality, however, inflation as measured that way is generally higher than the annual growth in the cost of living [because]—that is, than the amount of additional resources someone would need to maintain the same standard of living this year as last year in the face of rising prices. The reason for the difference is that many people can soften the impact of inflation on their standard of living by shifting some of their purchases away from goods or ser- vices that have risen in price toward ones that have not risen or have risen less. Even with such economic substitution, an increase in the price of a good lowers consumers’ standard of living (unless they value the old good and the new good equally). But the resulting decline in their standard of living is usually smaller than it would be if substitution were not possible. Thus, measures of inflation that do not account for such substitution overstate growth in the cost of living, a phenomenon known as substitution bias.One way to account for the effects of economic substitution would be to use a market basket of purchases from a period after the price changes being measured. However, the resulting measure of inflation would be biased down- ward, just as the current CPI is biased upward. Another approach [that] would avoid both types of bias. Since August 2002, BLS has published an alternative index, the chained CPI-U, that attempts to fully account for the effects of economic substitution on changes in the cost of living.4 The chained CPI-U provides an unbiased estimate of changes in the cost of living from one month to the next by using market baskets from both months, thus “chaining” the two months together.5

#### Chained CPI is more accurate because it looks at how consumer spending patterns change over time and uses those patterns to establish a more accurate cost of living- ensures that labor costs aren’t excessively high for employers.

#### MOTP 13 [Moment of Truth Project, The Moment of Truth project is a project of the Committee for a Responsible Federal Budget, a bipartisan, non-profit organization committed to educating the public about issues that have significant fiscal policy impact. The Committee is made up of some of the nation’s leading budget experts including many of the past Chairmen and Directors of the Budget Committees, the Congressional Budget Office, the Office of Management and Budget, the Government Accountability Office, and the Federal Reserve Board. “Measuring Up: The Case for the Chained CPI”, March 19, 2013, DDA]

With so much of government set to autopilot, the measurement we use for inflation plays a very important role in public policy. Currently, the federal government generally relies on the consumer price index (CPI) to index provisions of the budget and tax code to account for cost-of-living changes. However, this measure actually overstates inflation and, as a result, drives up the deficit unnecessarily. Maintaining purchasing power in spending programs and indexing various parts of the tax code is an important policy goal. However, policymakers should ensure that the most accurate measure of inflation is being used. To correct the problem of over-indexation, many have proposed switching to the chained CPI to provide a more accurate measure of inflation for indexed provisions in the federal budget. This switch was recommended by the National Commission on Fiscal Responsibility and Reform (“Fiscal Commission”) and the Bipartisan Policy Center’s Debt Reduction Task Force (“Domenici-Rivlin”). It was also a key component in negotiations on the debt ceiling last summer and the Super Committee last fall, and has a number of strong advocates from the left, right, and center (see http://crfb.org/blogs/ bipartisan-support-chained-cpi). An overwhelming majority of economists from both parties agree that the chained CPI is a far more accurate measure of inflation than the CPI measurements currently in use. In addition to improving technical accuracy, switching to chained CPI would have the secondary benefit of reducing the deficit – by about $390 billion over the next decade alone if implemented for 2014. Addressing our fiscal challenges will require many tough choices and policy changes – but switching to the chained CPI represents neither. Such a change offers policymakers the rare opportunity to achieve significant savings spread across the entire budget by making a technical improvement to existing policies. As such, across-the-board adoption of the chained CPI should be at the top of the list for any deficit reduction plan or down payment. Currently, the federal government relies on two cost-of-living measures for most inflation-indexed spending programs and provisions of the tax code: the CPI-U (Consumer Price Index for All Urban Consumers) and the CPI-W (Consumer Price Index for Urban Wage Earners and Clerical Workers). The CPI-W is used to calculate COLAs for Social Security and other federal retirement programs, while the CPI-U is used to index various provisions of the tax code, as well as poverty thresholds. The CPI-U is considered to be the more accurate of the two, since it covers 87 percent of the population, compared to the 32 percent covered by the CPI-W. The Bureau of Labor Statistics (BLS) formulates these price indices by creating a representative “market basket” of goods based on the covered population’s consumer spending patterns; in the case of the traditional CPIs, this data is available with a two-year time lag. Then, using this market basket, BLS tracks price changes for the included items over time. BLS follows the prices of goods in the market basket, and measures inflation based on the overall change in the price of the basket. In 1996, the Advisory Committee to Study the Consumer Price Index (the Boskin Commission) found that both CPI-U and CPI-W overstated inflation in a number of ways, which they estimated to total about 1.1 percentage points per year. The Bureau of Labor Statistics responded by making a number of changes to the way they measured CPI-U and CPI-W, which corrected much of the biases in the two indices. However, a portion of the bias – upper level substitution bias for changes between categories – cannot be addressed through the existing CPI-U and CPI-W for technical reasons. Instead, BLS created a new measure of inflation – the chained CPI (also known as the superlative CPI or the C-CPI-U) – in 2002 to account for consumer substitution between categories. This measure has been refined and improved since it was initially published. Unlike the methodological changes in the calculation of CPI-U and CPI-W that are automatically reflected in the published measures used for indexing programs under current law, using the more accurate chained CPI for indexation instead of the CPI-U or CPI-W requires a statutory change in law. One of the reasons the Boskin Commission found that the CPIs overstated price changes was something called substitution bias. Understanding substitution bias requires within categories. In particular, BLS adopted a recognizing the way consumers respond to changes in prices. If one spends $100 per month on apples and the price of apples suddenly doubles, it is unlikely that their cost of living will go up by $100. Rather, an individual will substitute away from apples, buying less of them than they otherwise would and therefore buying more of something else instead. Substitution bias occurs because the regular measure of CPI assumes consumers will buy the same basket of goods regardless of relative prices, not realizing that consumers can often soften the blow of increased relative prices by consuming more of a relatively cheaper good. Since the Boskin Commission, the BLS has made a number of improvements in the calculation of CPI-U and CPI-W to account for what is known as “lower level substitution bias,” when individuals substitute geometric mean in 1999 to account for consumer substitution within item categories as relative prices change. The geometric mean formula, though, does not account for consumer substitution taking place between categories – known as “upper level substitution.” For example, if consumers respond to the price increase for Granny Smith apples by buying more Red Delicious apples instead (lower level substitution bias – changes within categories), this is accounted for in the current CPI. But if consumers respond to the price of Granny Smith apples increasing by buying less apples altogether and purchasing more oranges instead (upper level substitution bias – changes between categories), this is not accounted for. Upper level substitution bias is an artifact of the BLS’s reliance on a fixed “market basket” of goods, which is based on old purchasing habits. This could be fixed by instead using a market basket based on the very newest purchasing habits, except that this would actually cause the opposite problem where substitution biases cause the CPI to understate inflation. Moving to the chained CPI would address this bias by using a superlative index that updates expenditure weights and formulas in order to address consumer response to substitution between categories. As the Congressional Budget Office (CBO) explains, the chained CPI “attempts to fully account for the effects of economic substitution on changes in the cost of living... [It] provides an unbiased estimate of changes in the cost of living from one month to the next by using market baskets from both months, thus ‘chaining’ the two months together.”2 Since 2000, the chained CPI has, on average, been 0.25 to 0.3 percentage points lower per year than the standard CPI measures. Though this difference is small on average, it compounds over time; depending on which index you use, prices have either increased by 34 percent (CPI-U and CPI-W) or 29 percent (chained CPI) between 2000 and 2011 (see Figure 1). Over a longer time frame, this difference would become even more pronounced.

#### Higher labor costs increase unemployment—studies prove

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Higher labor costs (higher wage rates and employee benefits) make workers better off, but they can reduce companies’ profits, the number of jobs, and the hours each person works. Overtime pay, hiring subsidies, the minimum wage, and payroll taxes are just a few of the policies that affect labor costs. Policies that increase labor costs can substantially affect both employment and hours, in individual companies as well as the overall economy. Higher labor costs reduce employment and/or the hours worked by individual employees. Laws that raise labor costs can either increase total employment or increase hours per worker, but they cannot do both. They lower the total amount of work performed in the market—the total number of person-hours (hours per worker multiplied by the number working). This loss must be traded off against the benefits that higher costs might provide to specific groups of workers. Every employer is concerned about labor costs—i.e. higher wage rates and employee benefits. An attractive package is essential for inducing people to apply for jobs and to work hard, but it will also subtract from the employer’s revenue and thus reduce profits. In any economy, policymakers confront this trade-off between imposing higher wage costs—for example, by introducing or raising a minimum wage—that benefit workers but reduce profits. Knowing how employers react to higher labor costs is essential to understanding how jobs are created and for predicting the economic impacts of labor legislation. DiSCUSSiOn OF PrOS anD COnS The central question here is whether an employer’s reaction to higher labor costs differs from a consumer’s reaction to increased shirt prices? In general they should not be different: In both cases we are looking at how somebody’s demand for something reacts to an increase in its price. With shirts, we expect that higher prices will lead customers to buy fewer shirts and to wear the shirts that they do buy for longer. With workers, higher costs will lead employers to use fewer employees and to use them more productively. In a few labor markets where one employer dominates or is the sole employer, the employer might respond differently; but such markets are rare, and increasingly so as labor forces grow and transportation improves. In fact the only important question is by how much employment falls when labor costs increase. It is not a question of whether it will fall, but rather one of how big the reduction will be. It is a more important question in the case of workers than of shirts because about 60% of all income in a modern economy is generated by employment. When labor costs increase, an employer’s immediate options are to do nothing and absorb the extra cost, or to reduce the amount of labor employed. It takes time to alter capital investments in machinery, buildings, and technology, which might allow a more efficient operation. On the other hand, changing workers’ hours, or the number of workers, is quicker and easier. So an employer’s first decision when labor costs rise is whether to do nothing or to reduce employment and/or hours; and, if the latter, by how much [1]. One set of evidence on this question comes from large-scale studies examining how employment changes in industries where hourly wages increase more rapidly than in other industries in which all other conditions are essentially similar [1]. These studies, conducted for many different countries and different industries, yield—unsurprisingly—a wide variety of conclusions. Nonetheless, a reasonable consensus from this vast body of research is that higher hourly wages induce employers to cut employment and hours worked. The best inference from these studies is that a 10% increase in labor costs will lead to a 3% decrease in the number of employees (or to a 3% reduction in the hours they work, or to some combination of both). This is sometimes referred to as the “3 for 10” rule.

1. Moody's is an essential component of the global capital markets, providing credit ratings, research, tools and analysis that contribute to transparent and integrated financial markets. Moody's Corporation (NYSE: MCO) is the parent company of Moody's Investors Service, which provides credit ratings and research covering debt instruments and securities, and Moody's Analytics, which offers leading-edge software, advisory services and research for credit and economic analysis and financial risk management. The Corporation, which reported revenue of $3.0 billion in 2013, employs approximately 8,500 people worldwide and maintains a presence in 31 countries. [↑](#footnote-ref-1)